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INTRODUCTION

1. This consultation paper is issued as part of the Government's drive towards deregulation and the easing of burdens on business. It focuses on areas in which the interaction of VAT rules and property law creates particular complexity and invites comments and proposals.

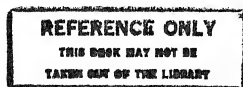
BACKGROUND

2. Major changes to the VAT legislation concerning land and buildings were made in 1989. The changes were necessary because the European Court of Justice had ruled that some of the UK's zero rates were in breach of EC Directives. Further changes were introduced at the beginning of 1992.

3. This area is particularly complex because:

- ° land law is complicated (and the law in England and Wales differs from the law in Scotland and that in Northern Ireland)
- ° we have to implement EC Directives (which are modelled more on European land law than on that in the UK)
- ° large sums are involved, which makes measures to prevent avoidance particularly important

4. We know that businesses find it difficult to understand some of the recent changes and we would like to simplify the law (so far as the constraints outlined above permit).



SCOPE OF REVIEW

5. Four areas are specifically addressed in this paper:

- the developer's self-supply charge
- the option to tax (election to waive exemption)
- licences to occupy land
- trusts and co-ownership of property

6. However, we would also be very interested in any comments or suggestions which you would like to make in relation to other areas of VAT legislation which affect property transactions. Some other areas in relation to which you may have comments are :-

- caravans and pitches
- lettings of sports facilities
- test of when a new building is "completed"
- parking

Transfers of going concerns

7. One further area of concern may be the application of the rules relating to the transfer of a business as a going concern ('TOGC') to property transfers. This is to be the subject of a separate consultation exercise through the issue of a draft leaflet. Nevertheless, if you wish to comment on this subject in the context of this consultation paper you are welcome to do so.

Liability of Domestic, Charity and Listed Buildings

8. While this consultation is primarily aimed at VAT and the commercial sector for land and property, we are conscious that the

domestic and charity area is not without its problems. We have therefore conducted an internal review in consultation with some representatives of outside interests. We would be happy to receive any comments and suggestions with regard to the interpretation of this area of the law (Group 8 and 8A, Schedule 5, VAT Act 1983). In particular we would welcome comments on the Court of Session findings in the case of Link Housing Association and the High Court decisions of Briararch and Curtis Henderson, including whether Group 8 item 1 should be amended to take account of these decisions, and if so, how.

TIMING OF ANY PROPOSED CHANGES

9. It is likely that many, if not all, of the changes which will result from this review will need a change in the law. Amendments to legislation will not be introduced before 1994/95.

YOUR COMMENTS

10. In this paper we suggest various ways in which the law or administrative practice might be changed in order to simplify and clarify the current rules. Our suggestions are not intended to be exhaustive and we would welcome details of any other arrangements which you believe we should consider.

11. In considering proposals for new regulations, the Government places great importance on the likely impact on business costs. To measure this impact, a Compliance Cost Assessment (CCA) is produced for all such proposals, and made available to businesses on request. Therefore, in giving your views on the proposals described in this document, it would be particularly helpful if you could identify and quantify any additional direct or indirect costs (recurring and non-recurring) that would be likely to arise for your sector of business as a result.

Recurring costs - e.g. extra administrators,
consumable materials

Non-recurring
costs - e.g. additional
expenditure on
computer systems and other
capital expenditure.

12. Your comments should be sent to us by 15 October 1993 and
should be addressed to :-

Ian Heron
HM Customs and Excise
VAF3
4th Floor West
New King's Beam House
22 Upper Ground
London SE1 9PJ

THE SELF-SUPPLY CHARGE

Current Provisions

13. The charge aims to ensure that there is no VAT advantage to be gained by buying land and then arranging for a building to be constructed rather than buying a ready-constructed new building. From 1 January 1992, the scope of the charge was extended to cover buildings which had been substantially reconstructed, enlarged or extended. This was to ensure that there was no tax advantage in reconstructing or enlarging an existing building rather than constructing a completely new building.

14. The self-supply charge applies to a person who constructs a building or commissions or finances its construction. It is triggered on the first occasion, during a ten year period, on which such a person puts the building to an exempt use, either by occupying it or by granting an interest in it to another. The person will, if registered for VAT, be entitled to recover the VAT incurred during the construction process. However, when the charge is triggered, VAT must be paid on the full value of the building (construction and land costs). In appropriate cases, the VAT paid can be recovered in accordance with the usual rules, with a possible adjustment under the Capital Goods Scheme (which permits certain VAT incurred in relation to a property to be recovered by reference to the use made of that property over a ten year period).

15. As yet there have been relatively few buildings which have fallen within the self-supply provisions. We would be grateful for any general comments you have about your experiences if you have been required to account for the self-supply charge.

Problems

16. The legislation in this area is very complicated. Furthermore, the scope of the charge is wide and it requires people engaged in wholly exempt activities, such as medical practitioners or fee-paying schools, to register for VAT purposes when they would not otherwise be required to register.

Suggestions

Retain the self-supply charge as it stands

17. The advantages would be that the charge succeeds in taxing land used for non-domestic building on a selective basis, by only applying where buildings are used for an exempt purpose, and that, for the reasons given above, it prevents distortion in the property market.

18. The disadvantages are that it brings otherwise unregistered people into the VAT net and that the provisions are complex and can be difficult to apply.

Modify the de minimis limits

19. Currently, buildings costing less than £100,000 (construction costs and land value) are excluded from the charge. Some reconstructed or enlarged buildings are also excluded by provisions which take into account the period of ownership of the land and degree of works involved. It would be possible to increase the £100,000 de minimis figure so as to exclude more developments from the self-supply charge and to streamline the criteria for determining when the charge is payable on reconstructed and enlarged buildings.

20. Another possibility would be to change the criteria for excluding small developments (e.g. by focusing on the amount of VAT paid on the land as a result of the charge or excluding from

the charge cases where VAT was paid on acquisition of the land as the result of an option to tax by the seller and/or cases where the land cost was minimal).

21. The advantage would be that fewer small developments would be brought within the provisions. This would potentially reduce the number of otherwise unregistered people who would have to register because of the self-supply charge. The disadvantage would be that some revenue would be foregone which might have to be made good elsewhere.

22. Alternatively, developers of lower value buildings could be relieved of the obligation to register for VAT and be allowed merely to render the VAT due on the land. This could, however, create difficulties in administration for Customs. There is also some doubt whether this would be permissible under the current structure of VAT.

Align the criteria for period of ownership

23. Under the current rules a new building is subject to the charge, no matter how long the land has been owned by the developer. However, certain extensions and enlargements are excluded from the charge if the majority of the building land has been owned for 10 years. These criteria could be aligned either by excluding from the charge all developments where the land has been owned for at least 10 years or by applying the charge to both new buildings and extensions etc. no matter how long the land has been owned by the developer.

Abolish the charge and tax "building land" on acquisition

24. The advantage of doing this would be that people who would not otherwise be required to register for VAT would no longer be obliged to register simply because they constructed or enlarged their business premises. Further, businesses would potentially be relieved of the need to review the use of their property over a

ten year period (though they might still need to do this for the Capital Goods Scheme). Overall there could be a reduction in the compliance burdens on businesses.

25. However, it would be necessary to find a suitable method of identifying commercial "building land" at the point of sale. This can be extremely difficult to identify because:

- land purchased on a speculative basis without planning permission may later be developed
- land sold with planning permission may remain undeveloped
- land intended to be used for domestic development may in fact be used for non-domestic development

26. The use to which the land is put becomes certain once development has commenced. However, EC Directives do not permit a self-supply charge on land alone, which is why the current charge applies to the whole building.

27. Moreover the Capital Goods Scheme, which facilitates the recovery of a fair proportion of the VAT incurred in relation to buildings, may not apply unless there is a lump sum of VAT due on the building on which adjustments can be made.

Abolish the charge and exempt building land

28. The advantages would be the reduction in the time devoted by businesses to tax affairs. It would not be necessary to define when land is "building land". Temporary measures under EC Directives would permit us to exempt building land from VAT for the time being.

29. The disadvantages of this would be the distortion in VAT treatment that would arise between buildings which were purchased new, with VAT added to the purchase price, and buildings which were self-developed. Furthermore, there would be a loss of revenue to the Exchequer, which may have to be recovered elsewhere.

OPTION TO TAX (ELECTION TO WAIVE EXEMPTION)

Current provisions

30. The option is a relieving provision. It enables VAT to be charged on certain property transactions which would otherwise be exempt and thereby permits the supplier to recover related input VAT (e.g. on construction costs or on legal fees). There are, however, certain conditions:

- the option is by building or area of land, not by lease
- the option can only take effect from a current or future date
- in most cases, written notification must be given to (or written consent obtained from) the taxpayer's local VAT office
- the option cannot be revoked (although it may sometimes cease to have effect - e.g. de-licensed public houses becoming dwellings or land sold to housing associations)
- a single option may bind groups of buildings and continuous stretches of agricultural land, whether or not that is what the taxpayer intends
- an option by a member of a VAT group binds the whole group
- there are some restrictions on the recovery of VAT incurred before an option takes effect

Problems

31. Generally, the provision has been welcomed. However, some businesses have experienced difficulty in:

- correctly notifying options
- appreciating the extent of the option and the fact that it is irrevocable
- working out whether or not several adjoining or adjacent buildings are affected by an option purporting to be made in relation to one building only
- calculating the correct amount of recoverable input tax (although provisions brought into effect on 1 January 1992 have gone some way towards rectifying this)

32. Overall the most common problems are in identifying what an option to tax covers and when the option takes effect.

Suggestions

Scope of the option to tax; parades, precincts and complexes.

33. The current legislation states that where "an election is made in relation to, or to part of, a building (or planned building), it shall have effect in relation to the whole of the building and all the land within its curtilage; and for the purposes of this sub paragraph buildings linked internally or by a covered walkway, and parades, precincts and complexes divided into separate units shall be taken to be a single building (if they otherwise would not be)".



Retain the existing provisions

34. The advantages of the current system are that the units within a shopping mall, retail park, industrial estate etc., are treated in the same manner for VAT purposes and there are no partial exemption problems over such things as development costs and service charges. The disadvantages are that it lacks flexibility and there has been uncertainty over the precise meaning of the provision (particularly the reference to "parades, precincts and complexes divided into separate units").

Amend the existing provisions

35. This would necessitate a definition to replace the reference to "parades, precincts and complexes" etc., which would be easy to apply and would produce equity in a range of different practical situations. We do not believe that such a definition exists and would be most interested in any suggestions which you may have!

36. Assuming that an appropriate definition could be devised, this would have the same advantages and disadvantages as the current provisions, save that there would be greater certainty in application.

Repeal some or all of the existing provisions

37. One approach would be to delete the second half of the provision (i.e. from "and for the purposes of this sub-paragraph" onwards). This would have the advantage of increasing flexibility for owners of large developments and would also avoid the uncertainty which arises under the current provisions. The disadvantage would be greater complexity in calculating the input VAT which the landowner was entitled to recover and in the administration of the tax, both for Customs and for taxpayers. Taxpayers who had previously been required to opt in relation to a larger area might wish to have the right to revoke part of that option. This might in turn lead to a partial claw-back of input VAT previously recovered.

Scope of the option to tax : agricultural land

38. The current legislation states that where an election is made in relation to agricultural land "it shall have effect in relation to any other agricultural land if that other land is not separated from it by -

- a) land which is not agricultural land; or
- b) agricultural land in separate ownership."

39. This often means that an election in relation to one farm or one estate can extend to cover very large areas of agricultural land automatically.

Retain the existing provisions

40. The advantages of the current system are that it avoids problems with borderlines between estates in the same ownership and, therefore, the current legislation creates an element of certainty. The disadvantage is that some landowners are deterred from opting to tax because of the sweeping nature of the option.

Amend the existing provisions

41. One approach would be to allow elections by farm or by estate, even if these adjoined other agricultural land in the same ownership. This would allow landowners more flexibility in making an election. The major difficulty would be determining the borderlines between where an election had effect and where it did not e.g. if land within one farm on which an election had effect was transferred to another farm where an election did not have effect.

42. We could also devise a suitable definition of what fell within "agricultural land" and we would welcome your comments on this.

Scope of the option to tax: by building or by lease

43. A similar approach to that suggested for agricultural land would be to permit options in relation to part only of a building. This would increase both the advantages and disadvantages outlined in paragraph 37.

44. It would be possible to amend the law to permit the option to be exercised by reference to a particular lease (or licence) rather than by reference to a particular building (so that the option would automatically cease to have effect on termination or expiry of that lease/licence). This would again have the advantage of giving landowners greater freedom to decide whether to opt (which may make the building unattractive to certain tenants) or to suffer irrecoverable input VAT. The disadvantage would be increased complexity in relation to input tax recovery.

Time limit on option

45. Another possibility would be to limit the duration of the option (e.g. to 10 years). At 10 years the landlord would be allowed to revoke the option if he so wished. This would have the advantages referred to in the preceding paragraph but would minimise the scope for avoidance. A disadvantage would be that there would be nothing to alert the tenant to the fact that the option had expired. It could also create serious problems in relation to input tax recovery and the self supply charge, create uncertainty and make administration by businesses and Customs more complicated.

Requirement to obtain permission to opt to tax

46. Currently businesses which have made exempt supplies of a property must obtain permission from Customs before they can opt

to tax. This is to allow agreement to be reached on the apportionment of input tax between the exempt and the future taxable supplies. Having obtained permission businesses should then notify Customs of their election. This two stage procedure creates an additional burden for businesses and can increase administration by local VAT staff.

47. One possibility which we have not fully explored would be to delete the provisions relating to input tax in the option to tax legislation (Schedule 6A, VAT Act 1983) and rely wholly on the normal partial exemption rules. This could allow businesses to opt to tax straight away, whether or not they had made any previous exempt supplies, and any input tax adjustments could be dealt with at a later date. The disadvantage of this would be that businesses would have no certainty as to the amount of input tax they would be entitled to reclaim.

48. A less radical adjustment would be to waive the requirement to ask Customs' permission for those businesses which did not seek to recover any input tax incurred prior to the election.

Notification of the option to tax

49. When a taxpayer has exercised the option to tax in respect of a building, he must provide written notice to Customs within 30 days unless he expects the total consideration for all supplies made of opted buildings over the next twelve months to be less than £20,000. The option may be exercised in respect of specific properties or more generally (e.g. "in relation to all property which I now own or may in the future acquire"). There is no special form for such notification.

Retain the existing provisions

50. The advantage of the current notification system is that taxpayers can choose how they wish to notify Customs of their option. Taxpayers who will make very small VATable supplies as

the result of opting are absolved by the £20,000 de minimis from any need to notify Customs. At the opposite end of the spectrum, taxpayers with large portfolios are freed from the need to list the properties to which the option applies (if the option is exercised in respect of a whole portfolio).

51. The disadvantage of the current system is that we do not receive adequate information about properties which are affected by an option. Many taxpayers notify us in a way which is ambiguous and we receive no details at all in cases to which the £20,000 de minimis applies or in which a "global" election has been made.

Amend the existing provisions

52. We are considering producing a form to notify options. If this happens, the use of this form will probably be compulsory unless an alternative is agreed with the local VAT office. A standard form will provide a structured format catering to the needs of most businesses. It will have the advantage of ensuring that all necessary details are provided to the local VAT office and it could include warnings to alert taxpayers about to opt for the first time to the consequences of doing so. A draft of the form will be available shortly. If you wish to see it, please contact us. A few businesses with very large property portfolios may wish to discuss with their local VAT office an alternative form.

53. In conjunction with the form we could abolish the £20,000 de minimis, which would ensure that we were notified of all options. For obvious reasons, we do not know how many taxpayers currently benefit from this provision and we would welcome information on this so that we may weigh the benefits against the increased compliance burden.

54. Taxpayers making "global" elections could be required to submit a schedule of the properties affected. Whilst this may appear to be an additional burden, we believe that this is

information which taxpayers must already have available for their own business purposes. The facility for making an election in respect of properties to be acquired in the future could be withdrawn and a separate option and notification in respect of each acquisition required. Alternatively, we could continue to permit a single option to apply to future acquisitions but require taxpayers to submit details of acquisitions, either on the occasion of each acquisition or, perhaps, quarterly. We recognise the need to achieve a balance between the provision of adequate information and the burden of excessive paperwork and would welcome your views on how this might best be achieved.

55. We would also welcome comments on whether the current separation of "making" an election and "notifying" an election causes any difficulty.

Miscellaneous

56. At present, there is no requirement that a landlord should seek the consent of his tenants prior to exercising the option to tax. Tenants may feel aggrieved if the landlord exercises the option without any warning, particularly if they have sub-let all or part of the premises and need therefore to opt themselves in order to recover all of the VAT charged on their rent. It might be possible to amend the law to require landlords to give advance warning to tenants and/or to seek their consent. We would welcome your views.

LICENCES TO OCCUPY LAND

Current provisions

57. The granting or assignment of any interest in, right over or licence to occupy land is normally exempt from VAT.

Problems

58. Neither VAT legislation nor land law in the UK defines what is meant by a licence to occupy land. Generally, the independent VAT Tribunals have viewed a licence to occupy land as the exclusive legal occupation of a defined area of land, where there is no tenancy created. What has been important is that the right should be to occupy the land and not merely to use the land. Thus, for example, the occupation of an office under a six-month licence is exempt, but admission to a theatre performance is standard-rated.

59. In the absence of a definition of a licence to occupy land, the Tribunals have in marginal cases been forced to decide where the line should be drawn between what is and what is not afforded exemption. This has sometimes resulted in the VAT treatment of what is ostensibly the same thing turning on the facts of individual cases. This has led to uncertainty.

Suggestions

Rules for each category

60. Our initial approach was to look at individual problems and we issued a consultation paper in 1990 on sites for coin-operated machines. We received few responses to this consultation and the results were inconclusive. Separate rules could be produced for each different category of licence (e.g. hairdressers' chairs,

coin-operated machines, advertising hoardings). This would have the advantages of certainty and of uniform treatment within a particular sector. The disadvantage would be that there would be no general rule to apply to new categories of licence.

A general rule

61. We wonder whether a longer term solution to this problem could be to define the term "licence to occupy land" for the purposes of VAT legislation. The difficulty which we anticipate is producing a definition which is workable in a wide range of different factual situations. Your suggestions would be appreciated.

62. The advantage of this is that it would create a borderline between exempt and standard-rated supplies which would be flexible enough to apply across different sectors. One disadvantage would be that any borderline might remove exemption currently enjoyed in one area, while offering a new exemption in another.

Suggestions

Retain the existing provisions

66. The advantage would be that the provisions as they stand are generally understood. The disadvantage would be that they are not flexible enough to provide a sensible answer in relation to the different kinds of trust and co-ownership.

Introduce special provisions

67. The advantage would be that the provisions would recognise the different types of arrangement and provide a sensible answer to the questions of who should exercise the option and who should register for the purposes of VAT.

68. The disadvantage would be that in seeking to clarify matters the legislation would inevitably become longer and more involved because it would need to take into account the various different circumstances.